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IN THIS ISSUE:

Bailouts By Japanese Banks Multiply 1

Plutonium Transport Mission Attracts Critical Mass 3

102nd Congress Adjourns 5

Defense Technology Transfers Still Cause Concerns 6

Tokyo Rejects Cray's Supercomputer Procurement Appeal 8

Bailouts By Japanese Banks Multiply

A key deadline for demonstrating financial soundness looms less than six months away, and Japan's big internationally minded commercial banks might be breathing more easily than they were just two months ago. At that time the Tokyo stock market's two-and-a-half-year downward spiral was imperiling the banks' goal of achieving capital equal to 8 percent of assets by March 31 of next year — an objective set for the world's big banks by authorities under what has become known as the Bank for International Settlements requirements. As a result of the recovery of the Tokyo stock market through the end of September, the March 1993 capital-assets goal appears within reach for the 14 large Japanese banks that are either nationwide commercial banks or long-term credit banks. However, the banks find themselves facing an array of new problems involving dozens of troubled companies that threaten to drown out any applause they otherwise might get six months from now.

Financial sources cited by *Nihon Keizai Shimbun*, the economic daily, say that Japan's major banks had capital equal to 8.7 percent of assets as of September 30. Although details were unavailable on which banks, if any, were under the 8 percent threshold, the ratio suggests that, at least for the average large bank, the BIS requirements will not be a problem unless the Tokyo stock market takes a substantial tumble before the end of March. Such a reaction could reduce substantially the 45 percent of paper securities profits that banks are allowed to count as capital. In reaching 8.7 percent, the banks also got a boost from the weak dollar, which reduces the reported yen value of dollar-denominated assets, and from capital raised in the form of subordinated loans.

Of course, major Japanese banks have seemed on the verge of meeting the 8 percent goal previously, only to see the prospect of achieving it recede along with the stock market. Given the continued volatility of the Tokyo market, that possibility cannot be dismissed, but more immediate problems loom larger for the banks. Japan's 11 city or nationwide commercial banks and three long-term credit banks sit at the top of a pyramidal banking structure, the bottom portions of which are looking increasingly shaky. As exemplified by loans to specialized housing finance companies (see Table), which face extreme financial difficulties as a result of lending for speculative real estate deals, nationwide commercial banks would appear to be little affected. Arguably facing the worst problems are some parts of the agricultural cooperative credit system, which is based on thousands of tiny credit associations throughout rural Japan. (Lack of comparable data may somewhat overstate the problems of the agricultural cooperatives relative to other financial institutions, however.)

Loans to Five Major Japanese Housing Finance Companies

(in billions of yen as of June 30, 1992)

	Loans to Housing Finance Companies	Total Lending	Share
Nationwide Commercial Banks	¥1,225.7	¥219,930.3	0.6%
Long-Term Credit Banks	1,254.0	47,619.4	2.6
Trust Banks	2,083.3	22,627.5	9.2
Agriculture-Related Financial Institutions*	4,392.1	31,300.2	14.0

*Include Norinchukin Bank plus Mutual Insurance Federations of Agricultural Cooperatives and Credit Federations of Agricultural Cooperatives. Data on total lending for the Mutual Insurance Federations of Agricultural Cooperatives are as of May 31, 1992.

Sources: Compiled from data in *Nihon Keizai Shimbun* and from Bank of Japan.

The figures in the Table also show that Japan's long-term credit banks and seven trust banks have a much larger combined exposure relative to total lending than the major commercial banks, a situation said to exemplify the general problems of long-term credit and trust banks in that both groups of financial institutions have close connections with Japan's 64 first-tier and 66 second-tier regional banks. Some of these latter institutions face severe problems in their loans to nonbank affiliates. As such, they have looked to the long-term credit banks and the trust banks for help.

However, neither group of potential saviors of regional banks is that healthy itself. The problems of Nippon Credit Bank, Ltd., the third-largest long-term credit bank, is a good case in point. Nippon Credit's problems with its financially troubled nonbank subsidiaries required the coordinated assistance of about 90 Japanese financial institutions, with the Norinchukin Bank, the apex of the agricultural credit system, a notable holdout (see *JEI Report* No. 37A, October 2, 1992). For their part, trust banks are caught on the wrong end of the yield curve. Trust banks make extensive use of long-term financing, the cost of which has declined less than that of short-term credit — likely to be favored by the nationwide commercial banks. Hence, the profitability of trust banks has lagged that of their larger rivals.

For trust banks the precedent established by Nippon Credit's problems with its nonbank subsidiaries is troubling. As a result of that agreement, financial institutions accepted dramatic cuts in the interest rates they charge the distressed companies, even in situations where they were not the main bank (traditionally defined to be the bank that extends more than 10 percent of a firm's total credit). Comparable situations were not long in emerging. For example, Hyogo Bank, Ltd., the

14th-largest regional bank, in early October reportedly asked four trust banks and other large Japanese banks to apply the discount rate on existing loans to three of its troubled nonbank subsidiaries. The discount rate, currently 3.25 percent, is the price of loans to banks from the Bank of Japan and is far below most short-term interest rates, particularly those charged for risky loans.

Of ¥873.2 billion ($7 billion at ¥125=$1.00) in loans outstanding to the three nonbank subsidiaries of Hyogo Bank as of August 31, Hyogo Bank itself accounted for 10.1 percent. The four trust banks collectively had 24.6 percent, with the largest individual share among them being the 7.6 percent share held by Sumitomo Trust & Banking Co., Ltd. Since the trust banks' cost of long-term funds exceeds 5 percent, the proposition of lending money at 3.25 percent would appear to be a nonstarter. Yet the trust banks may have no choice but to comply. Total loans to the three nonbanks from all institutions equal roughly one-third of Hyogo Bank's total lending, indicating that the regional bank alone would have great difficulty carrying the burden of below-market interest rates.

The effect of the Nippon Credit, Hyogo Bank and numerous other bailout cases increasingly is to shift the burden of troubled companies up the financial pyramid to big commercial banks, a situation rendered more likely to the extent that trust banks stiffen in their resistance to requests for financial assistance. Given the case-by-case approach being used with respect to troubled nonbanks, housing finance companies and even second-tier securities companies, the extent of the ultimate burden on the city banks remains unclear. As evidenced by the lower credit ratings of Japan's nationwide commercial banks after reassessments from international credit rating organizations, the ranks of doubters concerning the health of even the largest banks have increased this year. Achieving the 8 percent BIS standard next March, by no means a foregone conclusion, would be a much-needed feather in the caps of bankers at these institutions.

Douglas Ostrom

Plutonium Transport Mission Attracts Critical Mass

The chorus of foreign and domestic voices critical of the Japanese government's plan to ship plutonium fuel from Europe to Japan is growing louder and fuller. A specially fitted Japanese transport vessel, which began its first mission August 24, reportedly still is at sea. Despite the criticism, Tokyo seems determined, at present, to move ahead with its plan to bring 30 tons of recovered plutonium and uranium waste from Europe to Japan over the next two decades. The government considers the radioactive element a critical component of its ambitious nuclear power development program. The plan's repercussions, however, extend far beyond the immediate concerns over the safety of the shipment into the field of foreign policy.

Tokyo projects that Japan's nuclear power industry will burn 80 to 90 tons of plutonium fuel over the next several decades. This projection is in line with government plans to raise the share of electricity generated by nuclear power plants from the 26.7 percent contributed in FY 1991 to well over 30 percent within the next 15 years. When Tokyo drew up a master plan for nuclear power in the 1970s the high cost of uranium and concerns over secure access to the fuel focused attention on developing a "closed" nuclear fuel cycle that employed breeder reactors and plutonium fuel. While Tokyo is striving to develop an indigenous plutonium reprocessing capacity, much of the radioactive and highly toxic fuel needed for the country's nuclear plants during the next two decades will come from French and British reprocessing facilities. These plants extract plutonium from spent uranium fuel removed from Japanese nuclear facilities.

Because the enriched nuclear fuel used by Japan's nuclear power industry comes from the United States, Washington retains a say in its transport and use. Tokyo has consulted closely with the Departments of Energy and Defense and has obtained the Bush administration's approval of its plans to return recovered plutonium to Japan via ship.